

Message Text

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ACTION ARA-14

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E.O. 11652: N/A
TAGS: EFIN, AR
SUBJECT: INTEREST RATES IN ARGENTINA CONTINUE TO RISE

REF: BUENOS AIRES 7626

1. SUMMARY: INTEREST RATES IN ARGENTINA CONTINUE TO RISE AND REACHED AN ALL-TIME HIGH ON OCTOBER 20. COMMERCIAL BANKS ARE REPORTEDLY ATTEMPTING TO REACH A GENTLEMAN'S AGREEMENT TO AVOID DISRUPTIVE COMPETITION BUT VIABILITY OF AGREEMENT IS IN DOUBT. A FEW FINANCE COMPANIES MAY BE FORCED INTO BANKRUPTCY AS A RESULT OF AN INTEREST RATE SQUEEZE. ALTHOUGH INTEREST RATES HAVE REACHED HISTORIC LEVELS, THE REAL YIELD TO THE PUBLIC MAY STILL BE NEGATIVE.

2. INTEREST RATES IN ARGENTINA REACHED AN ALL-TIME HIGH ON OCTOBER 20 WHEN BANCO DE CHACO, A PROVINCIAL GOVERNMENT-OWNED BANK, OFFERED CUSTOMERS 11.25 PERCENT FOR 30-DAY MONEY OR AN EQUIVALENT OF 259 PERCENT COMPOUNDED ANNUAL RATE. THE BANCO DE CHACO RATE WAS CONSIDERABLY HIGHER THAN THAT OFFERED BY MOST COMMERCIAL BANKS, MANY OF WHICH HAD ENTERED INTO A "GENTLEMAN'S AGREEMENT" A COUPLE OF DAYS AGO TO AVOID DISRUPTIVE COMPETITION AND
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KEEP RATES OFFERED TO CUSTOMERS FOR 30-DAY DEPOSITS CLOSE TO THAT POSTED BY THE BANCO NACION. THE BANCO DE CHACO, AND MOST OTHER PROVINCIAL BANKS, WERE APPARENTLY NOT PART OF THIS GENTLEMAN'S AGREEMENT AND THEREFORE WERE FREE TO OFFER AND LEND AT RATES SUPPORTED BY THE MARKET. THE BANCO DE CHACO, AND OTHER PROVINCIAL BANKS, HAVE A COMPETITIVE ADVANTAGE OVER

PRIVATE COMMERCIAL BANKS ANYWAY IN THAT THEY DO NOT HAVE TO PAY TAXES ON THEIR LOAN OPERATIONS. THE PRESS SPECULATED THAT THE GOA WILL EXERT PRESSURE ON THE PROVINCIAL BANKS TO FALL IN LINE WITH THE GENTLEMAN'S AGREEMENT. SOURCE IN ONE MAJOR U.S. COMMERCIAL BRANCH SAID HE DOUBTED THAT GENTLEMAN'S AGREEMENT WOULD WORK AND THAT HE EXPECTED INTEREST RATES TO REMAIN HIGH OR EVEN RISE FURTHER UNTIL THE END OF THE YEAR -- A PERIOD IN WHICH CREDIT DEMAND IS NORMALLY HIGH. SOURCES EXPECT CENTRAL BANK TO MAINTAIN TOUGH POLICY AND NOT SUCCUMB TO PRESSURES TO EXPAND MONEY SUPPLY AT FASTER RATE.

3. FOR PRIME BORROWERS, THE COST OF 30-DAY MONEY IS CURRENTLY RUNNING AT ANNUAL COMPOUND RATE OF 385 PERCENT. SOURCES INDICATE THAT, EVEN AT THIS HIGH RATE, BORROWERS ARE DEMANDING MORE FUNDS THAN THEY CAN SATISFY. SOME MAJOR COMPANIES ARE REPORTEDLY RESORTING TO BORROWING FROM ABROAD, EVEN THOUGH THEY ARE REQUIRED TO ASSUME THE EXCHANGE RISK FOR A PERIOD OF A YEAR.

4. SOURCES DO NOT EXPECT INTEREST RATES TO CREATE FINANCIAL DIFFICULTIES FOR THE COMMERCIAL BANKS, MOST OF WHICH CONCENTRATED ON SHORT-TERM LOANS AND IN ANY CASE HAVE A CHEAP SOURCE OF FUNDS IN THE FORM OF DEMAND DEPOSITS. FINANCE COMPANIES, ON THE OTHER HAND, HAVE LIMITED OFFICIAL USE

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BEEN DEPENDENT ON SHORT-TERM DEPOSITS AS A SOURCE OF FUNDS AND HAVE LENT OUT A CONSIDERABLE PORTION OF THEIR FUNDS AT 180 DAYS. WITH THE RECENT RISE IN INTEREST RATES, THEY ARE NOW CAUGHT PAYING HIGH INTEREST RATES FOR THEIR SOURCE OF FUNDS TO COVER RELATIVELY LOW INTEREST LOANS MADE AT 180 DAYS. AS A RESULT, FINANCE COMPANIES ARE IN GENERAL HAVING DIFFICULTIES AND A FEW MAY GO BANKRUPT.

5. COMMENT: WHILE INTEREST RATES HAVE REACHED HISTORIC LEVELS, THE REAL YIELD TO THE PUBLIC IN OCTOBER WILL BE NEGATIVE IF INFLATION IS AT THE 12-14 PERCENT/MONTH RANGE AS EXPECTED; FOR THE BORROWERS, THE COST WILL PROBABLY BE POSITIVE, BUT NOT EXCESSIVELY SO. WITH INFLATION CONTINUING TO BE A MAJOR PROBLEM AND SHOWING AN UPWARD TREND AND GDP GROWTH IN THE THIRD QUARTER PROJECTED AT ALMOST 7 PERCENT, MINISTER OF ECONOMY MARTINEZ DE HOZ CLEARLY BELIEVES IT ESSENTIAL TO MAINTAIN A TIGHT MONEY POLICY TO PREVENT THE ECONOMY FROM OVERHEATING. IN THE PROCESS, HE WILL PROVOKE THE IRE OF THE BUSINESS COMMUNITY AND INVESTORS IN THE STOCK MARKET (ROBERTS INDEX HAS SHOWN

DECLINE OF 14 PERCENT IN THE PAST MONTH). ONLY TIME
WILL TELL IF HE CAN PULL IT OFF.
CHAPLIN

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